

**Office of Thrift Supervision**

Department of the Treasury

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August 24, 1999

**MEMORANDUM FOR:** Chief Executive Officers**FROM:**

Richard M. Riccobono

**SUBJECT:**

Homeowners Protection Act (HPA)

The Homeowners Protection Act of 1998 (HPA), which took effect on July 29, 1999, requires financial institutions to cancel private mortgage insurance (PMI) on residential mortgage loans under certain circumstances. The Act also requires financial institutions to provide borrowers with several disclosures at the time of loan origination, generally while mortgage insurance is in effect and when PMI terminates.

Although no federal banking agency has been authorized to write implementing regulations, each agency, including the Office of Thrift Supervision (OTS), has express authority to enforce this law. The agencies are currently working on interagency examination procedures that will provide guidance to examiners and financial institutions.

OTS had adopted interim examination procedures for the HPA. The purpose of these procedures is to provide oversight of, and preliminary guidance for, institution efforts to comply with the various PMI disclosure requirements and the requirements and conditions for cancellation and termination.

In this period before interagency examination procedures are adopted, OTS considers the primary risk of noncompliance to be in connection with the Act's disclosure requirements. By focusing on these requirements initially, the interim procedures should enable management to learn the new requirements, identify compliance needs, create the necessary new disclosures, and develop the appropriate policies and controls.

Since these interim procedures may not resolve all questions that will arise when interpreting this legislation, management may wish to consult with their appropriate legal counsel until an interagency consensus is developed in the form of FFIEC adopted procedures.

If you have questions concerning these procedures, please contact your respective Assistant Regional Directors for Compliance.

Attachment

**OTS Interim Examination Procedures for Compliance with the  
Homeowners Protection Act of 1998  
August 1999**

**Background and Summary**

The Homeowners Protection Act (HPA) of 1998 also known as the “PMI Cancellation Bill” or the Act, 12 U.S.C. §4901 et seq., requires financial institutions to cancel private mortgage insurance (PMI) under certain circumstances. The Act also requires institutions to give borrowers several disclosures: at the time of loan origination; annually while mortgage insurance is in effect; and, when the private mortgage insurance terminates. The Act permits more generous cancellation and termination policies than mandated by the statute’s requirements. The new law became effective on July 29, 1999, and generally applies only to single-family residential loans originated on or after that date. The one exception to the effective date is that residential mortgages originated before July 29, 1999 are subject to the annual disclosure requirements of the Act.

The requirements for borrower cancellation and automatic termination apply only to residential mortgage transactions. This is defined as a residential mortgage entered into on or after July 29, 1999. A residential mortgage transaction is a transaction in which a mortgage, deed of trust or other consensual security interest is created or retained against a single family dwelling that is the primary residence of the borrowers for the purpose of financing the acquisition, initial construction or refinancing of that dwelling.

The purpose of these procedures is to determine if an institution complies with the various PMI disclosure requirements and the relevant requirements and conditions for cancellation and termination. In this period before interagency examination procedures are adopted, OTS considers the primary risk of noncompliance to be in connection with the Act’s disclosure requirements. As interim procedures, this issuance is not intended to resolve all questions that may arise when implementing this legislation. Until an interagency consensus is developed in the form of FFIEC adopted procedures, examiners should consult designated agency resources for assistance.

**EXAMINATION OBJECTIVES**

To determine the adequacy of the institution’s policies, procedures, practices, and internal controls to ensure compliance with the Act.

To determine if the institution complies with the disclosure and notification requirements of the Act.

To determine if the institution complies with the cancellation and termination requirements of the Act.

## EXAMINATION PROCEDURES

### Disclosure Requirements

The Act establishes three different times when an institution must notify a consumer of his or her rights. Those times are:

- At loan closing;
- Annually; and
- Upon cancellation or termination.

The content of these required disclosures vary depending on whether PMI is borrower-paid (BPMI) or lender-paid (LPMI). The Act also provides for different disclosures (as well as cancellation and termination rights) for loans designated as “high risk.” Refer to the end of these procedures for more guidance on this special designation.

For all lenders requiring any PMI (lender or borrower-paid) on residential mortgage transactions, conduct a review of compliance systems as follows:

- Determine whether the institution has established disclosure policies, procedures, and practices with regard to the Act. Determine that all appropriate loan program disclosures are provided at loan closing. [§4903(a)]
- Determine that borrowers are not charged for any disclosures or notices provided pursuant to the Act. [§4906]

#### *Initial Disclosure - Borrower Paid PMI (BPMI)*

At loan closing, an institution must disclose to borrowers their right to cancel BPMI. Different disclosure requirements apply to fixed-rate and adjustable-rate mortgages. These obligations deal only with loans originated on or after July 29, 1999.

- Determine that the institution’s loan program disclosures include all of the following required disclosures, as applicable:

#### Fixed rate mortgages

- a. A written initial amortization schedule [§4903(a)(1)(A)(i)];
- b. Written notice of the date on which the borrower may request cancellation based on the original amortization schedule [§4903(a)(1)(A)(ii)(I)];

- c. Written notice that the borrower may request cancellation earlier than the date on the amortization schedule based on actual payments [§4903(a)(1)(A)(ii)(II)];
- d. Written notice that the mortgage insurance requirement will automatically terminate and the date of that automatic termination [§4903(a)(1)(A)(ii)(III)]; and,
- e. Notice that there are exceptions to the right to cancel and to automatic termination for high risk loans and that such exceptions do not apply [§4903(a)(1)(A)(ii)(IV)].

#### Adjustable-rate mortgages

- a. Written notice that, subject to conditions, the borrower may cancel private mortgage insurance on the cancellation date, and that the servicer will notify the borrower when the cancellation date is reached [§4903(a)(1)(B)(i)];
- b. Written notice that the requirement for private mortgage insurance will automatically end on the termination date and that the lender will notify the borrower of that date [§4903(a)(1)(B)(ii)]; and,
- c. Written notice that there are exceptions to the right to cancel and to automatic termination for high risk loans and that such exceptions do not apply [§4903(a)(1)(B)(iii)].

#### High risk loans

- a. Written notice that BPMI may in no case be required beyond the date that is the midpoint of the amortization period of the loan, if the borrower is current on payments required by the terms of the mortgage [§4903(a)(2)].

#### *Initial Disclosure - Lender paid PMI*

For residential mortgage loans with lender paid mortgage insurance (LPMI), made on or after July 29, 1999, lenders must provide initial disclosures to borrowers no later than the date of the loan commitment. The requirements for initial disclosures for these loans focus primarily on the differences between BPMI and LPMI.

- If the institution makes loans with LPMI, determine that the disclosures include all of the following required disclosures, as applicable.

- a. Written notice that LPMI differs from BPMI, in that LPMI may not be canceled by the borrower, while BPMI could be canceled by the borrower or automatically terminate in accordance with the HPA [§4905(c)(1)(A)];
- b. Written notice that LPMI usually results in a higher interest rate than BPMI [§4905(c)(1)(B)(i)];
- c. Written notice that LPMI only terminates when the transaction is refinanced, paid off, or otherwise terminated [§4905(c)(1)(B)(ii)];
- d. Written notice that LPMI and BPMI both have benefits and disadvantages and a generic analysis reflecting the differing costs and benefits of each over a 10-year period, assuming prevailing interest and property appreciation rates [§4905(c)(1)(C)]; and,
- e. Written notice that LPMI may be tax-deductible for federal income taxes if the borrower itemizes expenses for that purpose[§4905(c)(1)(D)].

### **Annual Disclosure Requirements**

Under the Act, mortgage loan servicers must provide to borrowers with residential mortgage loans requiring BPMI an annual written statement that states their rights to cancel PMI and the address and telephone number of the servicer to contact to determine whether PMI may be canceled. Because some of the HPA cancellation rights apply only to loans consummated on or after July 29, 1999, the disclosures requirements vary depending upon when a loan was consummated. There are no annual disclosure requirements for loans with LPMI.

At the discretion of the servicer, the annual disclosures could be made on the anniversary of the transaction or be made as part of, or in conjunction with, the regular annual RESPA escrow accounting disclosures or annual disclosures of interest payments pursuant to IRS regulations.

The following procedures apply to institutions that provide mortgage loan services and only to the mortgage loans they service. Institutions that have sold the servicing rights to their originations need not be examined for compliance with this section.

- For mortgage loans originated on or after July 29, 1999, for which the lender required BPMI, determine if the servicer provides borrowers with annual written disclosures including:
  - a. A statement describing their rights to cancel PMI [§4903(a)(3)(A)]; and
  - b. An address and telephone number of the servicer to ask whether the borrower may cancel the PMI [§4903(a)(3)(B)].

- For mortgage loans originated before July 29, 1999, for which the lender required BPMI, determine if the servicer provides borrowers with annual written disclosures including:
  - a. A statement that PMI may, under certain circumstances, be cancelled (such as with the consent of the mortgagee or, if applicable, in accordance with State law) [§4903(b)(1)]; and
  - b. An address and telephone number of the servicer to contact to determine whether PMI may be canceled [§4903(b)(2)].

### **Cancellation and Termination Disclosure Requirements**

The obligation for providing notice of cancellation or termination is with the servicer of the mortgage. Accordingly, this section applies only to those institutions that are engaged in residential mortgage servicing.

#### *Borrower Paid Mortgage Insurance*

As a practical matter, since these disclosure obligations only pertain to loans made after July 29, 1999, most loans are not likely to trigger cancellation or termination rights for some significant period of time. Nevertheless, examiners should review an institution's policies, procedures, and internal controls to determine that when it acts as a servicer it is prepared to identify loans subject to automatic termination and to ensure timely and adequate notice to borrowers of cancellation or termination, or failure to meet the requirements for cancellation or termination.

- Determine through a review of the institution's policies, procedures, and practices, if its controls are adequate to identify loans subject to automatic termination.
- Verify that in any case that a servicer has determined that a loan did not meet the requirements for automatic termination or cancellation that a written notice of the grounds relied on in making the determination, including the results of any appraisal used to make the determination, is provided to the borrower [§4904(b)(1)].
- Verify that written notice of any determination that a loan did not meet the requirements for termination or cancellation was provided within
  - 30 days of the scheduled termination date [§4904(b)(2)(B)], or
  - in the case of cancellation, within 30 days of the later of (i) the borrower's request for cancellation is received or (ii) the borrower satisfies the evidence and certification requirements [§4904(b)(2)(A)].

- Verify that the servicer has established in advance what evidence borrowers requesting cancellation of the PMI requirement must give that the value of the property securing the mortgage has not declined below the original value of the property and that the institution has procedures to ensure that it promptly notifies borrowers of pertinent evidentiary standards after receipt of cancellation requests [§4902(a)(3)(A)].
- Determine through a review of the servicer's policies, procedures, and practices, if written cancellation or termination notices are provided within 30 days after cancellation or termination [§4904(a)].
- Review a judgmental sample of cancellation/termination notices to determine if the notices contain the following required provisions, as applicable:
  - a. A statement that PMI has been terminated and the borrower no longer has PMI [§4904(a)(1)]; and,
  - b. A statement that no further premium payments are due [§4904(a)(2)].

#### *Lender Paid Mortgage Insurance*

Although the Act's cancellation and termination requirements do not apply to residential mortgage transactions with LPMI, a written notice advising the borrower that he or she may wish to review financing options that eliminate the requirement for LPMI is required. This notice must be given within 30 days of the termination date that would have applied if it were a BPMP transaction.

- If LPMI is required, determine whether the institution's policies, procedures, and practices ensure that disclosures are provided within 30 days of the termination date that would have applied if the lender required BPMP rather than LPMI [§4905(c)(2)].
- Review a judgmental sample of LPMI termination notices to determine if they state that the borrower may wish to review financing options that could eliminate the requirement for LPMI [§4905(c)(2)].
- Verify whether the LPMI termination notice was provided within 30 days after the termination date that would have applied if the institution had required BPMP [§4905(c)(2)].

#### **Requirements and Conditions for Cancellation and Termination**

The Act establishes three ways in which mortgage insurance may be canceled or terminated. These provisions apply only to BPMP. They include the following:

- Borrower requested cancellation;
- Automatic termination; and
- Final termination.



The cancellation and termination rules do not apply to:

- mortgages originated before the effective date;
- mortgages on other than single-family dwellings;
- mortgages on second homes or non-owner occupied property,
- mortgages obtained for purposes other than acquisition, construction, or refinancing of a dwelling, or
- mortgages designated as high-risk loans (except that final termination does apply).

As previously noted, loans made after July 29, 1999, are not likely to amortize, or have their underlying properties appreciate sufficiently to trigger cancellation or automatic termination rights in the near term. Nevertheless, when an institution services residential mortgages, examiners should review its policies, procedures and internal controls to determine its preparedness to deal with these requirements and to ensure that the appropriate systems are, or will be timely, in place to prompt the appropriate actions.

### **Borrower Cancellation**

A borrower who has reached the cancellation date with a good payment history may submit a request in writing to the mortgage servicer to terminate the PMI requirement. The holder of the mortgage may require the borrower to submit evidence that the value of the property securing the mortgage has not declined below the original value of the property and that the equity of the mortgagor in the property is unencumbered by a subordinate lien.

Mortgage insurance must be canceled at the borrower's request on or after the date the initial amortization schedule indicated the loan would have an 80 percent LTV ratio or at any earlier date that the loan has an 80 percent LTV based on actual payments.

- Determine if the institution has adequate servicing policies, procedures and controls to ensure that borrowers' requests for cancellation of PMI requirements are honored for all residential mortgage transactions that meet the following requirements:
  - the request for cancellation is in writing to the servicer [§4902(a)(1)];
  - evidence is presented that the property value has not depreciated below the original value (defined as the sales price or value appraised during underwriting, whichever is lower) [§4902(a)(3)(A)];
  - the borrower certifies no subordinate lien [§4902(a)(3)(B)]; and
  - the borrower's payment history is good (i.e., no past due mortgage payments of 60+ days within the last two years or 30+ days within the last year, see, §4901(4)) [§4902(a)(2)].

- Verify that the servicer's systems cancel PMI
  - within the later of 30 days of (i) receiving the mortgagor's request, or (ii) the date the mortgagor satisfies any evidence and certification requirements allowed by law [§4902(d)(1)], and
  - corrects mortgagor's payment schedules [§4902(d)]
- Verify that the servicer ensures that unearned PMI premium payments are returned to the mortgagor within 45 days [§4902(e)(1)].

### **Automatic Termination**

The HPA defines the automatic termination date as the date on which the original amortization schedule shows the principal balance will decline to 78 percent of the original value of the property. On the automatic termination date, if a borrower is current with the loan payments required under the terms of the mortgage, then the PMI requirement automatically terminates, otherwise it automatically terminates as soon as the loan is brought current.

- Verify that servicer's systems
  - terminate PMI within 30 days of (i) the automatic termination date (the date the LTV reaches 78 percent of the original value of the property) if the borrower is current on his payments), or (ii) the date as soon thereafter as the borrower becomes current [§4902(d)(2)], and
  - that mortgagor's payment schedules conform to this change [§4902(d)].
- Verify that the servicer ensures that unearned PMI premium payments are returned to the mortgagor within 45 days [§4902(e)(1)].

### **Final Termination**

For mortgage loans with PMI that were originated after July 29, 1999, the requirement for PMI not otherwise canceled or terminated must be removed at the midpoint of the amortization, if the mortgagor is current on the payments. On a 30-year mortgage, for example, the chronological midpoint would occur after 180 payments.

- Determine through a review of the institution's servicing policies, procedures, and practices if final termination of PMI is addressed [§4902(c)].
- Review the adequacy of the institution's servicing systems for terminating PMI at the midpoint of the amortization.

### **High-Risk Loans**

The Act permits Fannie Mae and Freddie Mac to issue guidance on what constitutes high-risk loans for all mortgages with the conforming secondary market loan limits. At the time these interim procedures were issued, neither GSE had designated any conforming secondary market mortgage loans as “high risk.”

For non-conforming mortgages above the current GSE limit of \$240,000, the lender may designate mortgage loans as high risk. The standards for such a designation are not dictated by the Act. However, the Act does require lender designated high-risk loans to terminate PMI when the original amortization schedule indicates an LTV of 77%, as well as in accordance with the final termination rules.

- Determine whether the institution has designated any loans larger than the secondary market limits as high-risk, has articulated a prudent business reason for such a designation, and observes the statutory requirements for cancellation of PMI for such loans [§4902(f)(1)(B)].